

JS-6

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

IN RE MARCUS ALBERT ROMERO
AND NATALIA VICTORIA
ROMERO,

Appellants.

Case No. 5:23-cv-01010-FLA
Case No. 5:23-cv-01907-FLA
Case No. 6:22-bk-12942-WJ

**ORDER AFFIRMING
BANKRUPTCY COURT'S MAY 2
AND SEPTEMBER 8, 2023 ORDERS**

RULING

Appellants and Debtors Marcus Albert Romero and Natalia Victoria Romero (“Appellants” or “Debtors”) appeal Orders by the United States Bankruptcy Court for the Central District of California (the “Bankruptcy Court”) in Case No. 6:22-bk-12942-WJ (the “Bankruptcy Action,” or “Bankr. Case 22-12942”). Dkts. 8, 26. The Chapter 7 Trustee of Appellants’ Bankruptcy Estate, Todd A. Frealy (“Appellee” or the “Trustee”), requests this court affirm the Bankruptcy Court’s Orders. Dkts. 9, 27. On October 12, 2023, the court consolidated these two appeals, with Case 5:23-cv-01010-FLA designated the lead case. Dkt. 21.¹ The court finds these appeals

¹ All citations to the docket shall be to Case 5:23-cv-01010-FLA unless specified otherwise.

appropriate for resolution without oral argument. Fed. R. Civ. P. 78(b); Local Rule 7-15.

For the reasons stated herein, the court AFFIRMS the Bankruptcy Court's May 2 and September 8, 2023 Orders and DISMISSES the subject appeals.

BACKGROUND

On August 4, 2022, Debtors filed a Voluntary Petition for Bankruptcy ("Bankruptcy Petition"), requesting relief under chapter 7 of the United States Bankruptcy Code.² Bankr. Case 22-12942, Dkt. 1. Debtors' Official Form 106A/B (Schedule A/B) listed assets including a single-family home located at 45119 Riverstone Court, Temecula, California (the "Residence"), which they valued at \$1,254,300. EOR 00022.³ Pursuant to California Code of Civil Procedure § 704.730 ("CCP § 704.730"), Debtors claimed a homestead exemption on their Official Form 106C (Schedule C) of \$53,464.40, EOR 00031, which they amended to \$558,000, on February 17, 2023, EOR 00297.

Debtors' Official Form 106D (Schedule D) identified the following creditors with secured claims against the Residence, in order of priority:

1. Chase Bank: first deed of trust of \$521,585.60;
2. Cenlar Mortgage: second deed of trust of \$258,223.00;
3. Financial Casualty and Surety ("FCS"): third deed of trust of \$250,000.00;
4. Internal Revenue Service: first federal tax lien of \$48,673.00; and
5. Internal Revenue Service: second federal tax lien of \$122,354.00.

EOR 00033–35, 93; Dkt. 8 (Debtors' Opening Br.) at 5; Dkt. 9 (Tr. Answering Br.) at 7–8. The parties additionally state the Riverside County Tax Collector is owed

² All statutory references shall be to title 11 of the United States Code (the "Bankruptcy Code") unless specified otherwise.

³ The Excerpts of Record ("EOR") were filed as Dkts. 8-1 through 8-4, 10, 26-1, and 28.

1 \$6,625.25 in property taxes. Dkt. 8 at 5; Dkt. 9 at 10. These liens total
2 \$1,207,460.60.

3 On February 10, 2023, the Trustee filed in the Bankruptcy Action: (1) a Motion
4 to Approve Stipulation with Secured Creditor Financial Casualty Surety, Inc.
5 Regarding Treatment of Secured Claim in Connection with Sale of Estate Property ...
6 (the “Compromise Motion,” EOR 00149–55); and (2) an Objection to Debtors’ Claim
7 of Exemption (the “Objection to Exemption,” EOR 00156–217). In the Compromise
8 Motion, the Trustee stated he had reached an agreement with FCS whereby FCS
9 consented to a sale of the Residence on the condition that FCS receive 60% of the
10 proceeds encumbered by FCS’ deed of trust from the sale of the Residence, after the
11 first and second deeds of trust, the costs of sale, and any unpaid real property taxes
12 were paid, with the remaining 40% to be a carve-out for the benefit of the bankruptcy
13 estate. EOR 00150. The Objection to Exemption sought to disallow Debtors’ claim
14 of a homestead exemption concerning the Residence, on the grounds that California’s
15 exemption laws do not protect property from the enforcement of consensual liens.

16 On February 14, 2023, Debtors filed a Motion for Order to Compel
17 Abandonment of Property of the Estate (the “Abandonment Motion”), requesting the
18 Bankruptcy Court compel the Trustee to abandon the Residence on the grounds there
19 was no remaining equity after payment of the secured claims and tax liens, and that
20 the Residence was of inconsequential value and benefit to the bankruptcy estate. EOR
21 00218–94.

22 These matters came to hearing on March 7 and May 2, 2023. EOR 00002, 572–
23 621. After considering the parties’ arguments, the Bankruptcy Court issued a tentative
24 ruling granting the Compromise Motion, denying the Abandonment Motion, and
25 sustaining in part the Objection to Exemption. EOR 00592–603, 615–20. The
26 Bankruptcy Court noted Debtors over-encumbered the Residence with three
27 mortgages voluntarily, such that there was no remaining equity to which the
28 homestead exemption could attach. EOR 00592–93. The Bankruptcy Court further

1 noted the Trustee acted within his fiduciary duties by entering into the agreement with
2 FCS to recover money for the benefit of unsecured creditors, that FCS acted within its
3 rights by assigning a portion of the proceeds of its secured lien to the bankruptcy
4 estate, and that the assignment would provide a meaningful recovery for the unsecured
5 creditors. EOR 00593–96, 599–600, 615–17.

6 On May 2, 2023, the Bankruptcy Court issued an order adopting the findings of
7 fact and conclusions of law from the March 7 and May 2, 2023 hearings and: (1)
8 granting the Trustee’s Compromise Motion; (2) denying Debtors’ Abandonment
9 Motion; and (3) sustaining in part the Trustee’s Objection to Exemption, finding
10 “[t]he homestead exemption of the Debtors attaches to any and all net sales proceeds
11 of the home (after payment of all secured claims, real estate taxes, closing costs, etc.)
12 but does not attach to any sales proceeds attributable to the portion of the consensual
13 lien of [FCS] which FCS assigned to the bankruptcy estate for the benefit of creditors
14 pursuant to the stipulation approved by the [Bankruptcy] Court.” EOR 00002.

15 On August 15, 2023, the Trustee filed a Motion for Order: (1) Authorizing Sale
16 of Estate’s Right, Title and Interest in Real Property Free and Clear of Liens...; (2)
17 Approving Overbid Procedure; (3) Approving Payment of Real Estate Brokers’
18 Commissions and Related Closing Costs; and (4) Finding Purchasers are Purchasers in
19 Good Faith (the “Sale Motion”). EOR 00634–753. The Sale Motion came to hearing
20 on September 5, 2023, and the Bankruptcy Court granted the Sale Motion on
21 September 8, 2023. EOR 00780–81, 785–807.

22 Debtors appeal the Bankruptcy Court’s May 2 and September 8, 2023 Orders.

23 **MAY 2, 2023 ORDER**

24 **I. Issues**

- 25 1. Whether there was a compromise between the Trustee and FCS under Fed.
26 R. Bankr. P. 9019 (“Rule 9019”), and whether the Bankruptcy Court abused
27 its discretion in approving the compromise.
- 28 2. Whether Debtors’ homestead exemption attaches to the portion of FCS’
recovery from the sale of the Residence that FCS carved out/assigned to the

1 bankruptcy estate under its compromise with the Trustee.⁴

- 2 3. Whether the Residence should have been abandoned given the Residence
3 was over-encumbered and Debtors' homestead exemption, or whether the
4 Trustee was able to sell the Residence lawfully based on the compromise
with FCS.

5 Dkt. 8 at 10; Dkt. 9 at 2–3.

6 **II. Legal Standard**

7 On appeal, a district court “review[s] the bankruptcy court’s findings of fact
8 under the ‘clearly erroneous’ standard and its conclusions of law *de novo*.” *In re A &*
9 *C Props.*, 784 F.2d 1377, 1380 (9th Cir. 1986). A bankruptcy court’s decision to
10 approve or deny a compromise or to authorize or deny abandonment is reviewed for
11 abuse of discretion. *Id.*; *In re Johnston*, 49 F.3d 538, 540 (9th Cir. 1995). “The
12 determination of a homestead exemption based on undisputed facts is a legal
13 conclusion interpreting statutory construction which is reviewed *de novo*.” *In re*
14 *Chappell*, 373 B.R. 73, 76 (B.A.P. 9th Cir. 2007). “Whether property is included in a
15 bankruptcy estate is a question of law also subject to *de novo* review.” *Id.*

16 “A bankruptcy court abuses its discretion when it applies the incorrect legal rule
17 or its application of the correct legal rule is ‘(1) illogical, (2) implausible, or (3)
18 without support in inferences that may be drawn from the facts in the record.’” *In re*

19
20 ⁴ Debtors identify this Issue as: “Whether the bankruptcy court erred in entering an
21 order on the Chapter 7 trustee’s objection to the Debtors’ homestead exemption when
22 the motion stated no actual objection to the exemption claimed and the ruling was
23 nothing more than an advisory opinion from the bankruptcy court about how funds
24 should be dispersed upon a future sale of the Debtors’ residence which was in
25 violation of the Code, *Tillman*, and *Jevic* by ruling that the Trustee did not have to pay
26 the Debtors’ homestead exemption from the sale proceeds.” Dkt. 8 at 10. Debtors’
27 statement does not accurately describe the Issue presented, for reasons including that
28 Debtors do not provide any argument or legal authority to support their assertions that
the Objection to Exemption “stated no actual objection to the exemption claimed” and
the Bankruptcy Court’s ruling on the Objection to Exemption was an advisory
opinion. *See* Dkts. 8, 11. This encapsulation of the Issue more properly captures the
issue raised and argued by the parties in this appeal.

1 *KVN Corp.*, 514 B.R. 1, 5 (B.A.P. 9th Cir. 2014) (quoting *United States v. Loew*, 593
2 F.3d 1136, 1139 (9th Cir. 2010)). A determination by the bankruptcy court that rests
3 on an erroneous interpretation of law constitutes an abuse of discretion *per se*. *In re*
4 *Debbie Reynolds Hotel & Casino, Inc.*, 255 F.3d 1061, 1065 (9th Cir. 2001).

5 **III. Discussion**

6 **A. The Basic System of Priority for Distributing Assets of the Estate, the** 7 **Homestead Exemption, and Carve-Out Agreements**

8 “Under § 704(a)(1), a chapter 7 trustee has the duty to ‘collect and reduce to
9 money the property of the estate for which such trustee serves....’” *KVN*, 514 B.R. at
10 5 (citing 11 U.S.C. § 704(a)(1)). “To fulfill this duty, the trustee’s primary job is to
11 marshal and sell the assets, so that those assets can be distributed to the estate’s
12 creditors.” *Id.* (quotation marks and citations omitted). “Indeed, a core power of a
13 bankruptcy trustee under § 363(b) is the right to sell ‘property of the estate’ for the
14 benefit of a debtor’s creditors.” *Id.*

15 A bankruptcy trustee may sell property of the estate “free and clear of any
16 interest in the property of an entity other than the estate” if:

- 17 (1) applicable nonbankruptcy law permits sale of such property free
18 and clear of such interest;
- 19 (2) such entity consents;
- 20 (3) such interest is a lien and the price at which such property is to be
21 sold is greater than the aggregate value of all liens on such property;
- 22 (4) such interest is in bona fide dispute; or
- 23 (5) such entity could be compelled, in a legal or equitable proceeding,
24 to accept a money satisfaction of such interest.

24 11 U.S.C. § 363(f).

25 “The [Bankruptcy] Code ... sets forth a basic system of priority, which
26 ordinarily determines the order in which the bankruptcy court will distribute assets of
27 the estate.” *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 457 (2017) (erroneously
28 cited by Debtors as *Cryzewski v. Jevic Holding Corp.* (*see, e.g.*, Dkt. 8 at 3)).

1 “Secured creditors are highest on the priority list, for they must receive the proceeds
2 of the collateral that secures their debts.” *Id.* (citing 11 U.S.C. § 725). “Special
3 classes of creditors, such as those who hold certain claims for taxes or wages, come
4 next in a listed order.” *Id.* (citing 11 U.S.C. §§ 507, 726(a)(1)). “Then come low-
5 priority creditors, including general unsecured creditors.” *Id.* (citing 11 U.S.C.
6 §726(a)(2)).

7 “[I]n some circumstances, a debtor may exempt property from the bankruptcy
8 estate, thereby removing it from the bankruptcy estate.” *In re Tillman*, 53 F.4th 1160,
9 1163 (9th Cir. 2022). “In such circumstances, the debtor generally retains the exempt
10 property, and the exempt property cannot be used by the bankruptcy estate to satisfy
11 the claims of unsecured creditors.” *Id.* (citing *Owen v. Owen*, 500 U.S. 305, 308
12 (1991)). “Section 522 of the Bankruptcy Code enumerates exemptions available to an
13 individual debtor in bankruptcy, but § 522(b)(1) also authorizes state legislatures to
14 ‘opt out’ of the § 522 exemption scheme and provide their own exemption schemes.”
15 *Id.* “‘If a State opts out, then its debtors are limited to the exemptions provided by
16 state law.’” *Id.* (quoting *Owen*, 500 U.S. at 308).

17 “California has opted out of the federal bankruptcy exemption scheme, so its
18 debtors claim exemptions under state law.” *In re McKee*, 90 F.4th 1244, 1247 (9th
19 Cir. 2024) (citing Cal. Code Civ. Proc. § 703.130). “California’s homestead
20 exemption laws are set forth in Article 4 (§§ 704.710 through 704.850) and Article 5
21 (§§ 704.910 through 704.995) of Title 9 (Enforcement of Judgments), Division 2,
22 Chapter 4 of the [California Code of Civil Procedure].” *In re Kelley*, 300 B.R. 11, 17
23 (B.A.P. 9th Cir. 2003). Debtors claim the Article 4 “automatic” homestead exemption
24 here, pursuant to California Code of Civil Procedure § 704.730. EOR 00031; Dkt. 8
25 at 18. “That exemption protects a debtor who resides (or who is related to one who
26 resides) in the homestead property at the time of a forced judicial sale of the
27 dwelling.” *McKee*, 90 F.4th at 1247 (quotation marks omitted) (citing Cal. Code Civ.
28 Proc. § 704.720(a)). “The filing of a bankruptcy petition constitutes a forced judicial

1 sale for this exemption.” *Id.* The “automatic” homestead exemption is entitled to
2 lower priority than secured claims and tax liens, and higher priority than unsecured
3 claims. Cal. Code Civ. Proc. §§ 703.010(b), 704.850.

4 “It is universally recognized ... that the sale of a fully encumbered asset is
5 generally prohibited.” *KVN*, 514 B.R. at 5 (collecting cases). “In that instance, the
6 trustee’s proper function is to abandon the property, not administer it, because the sale
7 would yield no benefit to unsecured creditors.” *Id.* at 6. “Despite the general rule
8 prohibiting the sale of fully encumbered property, chapter 7 trustees may seek to
9 justify the sale through a negotiated carve-out agreement with the secured creditor.”
10 *Id.* “A carve-out agreement is generally understood to be an agreement by a party
11 secured by all or some of the assets of the estate to allow some portion of its lien
12 proceeds to be paid to others, i.e., to carve out its lien position.” *Id.* (quotation marks
13 and citation omitted).

14 “There is no per se rule that bans this type of contractual arrangement: Creditors
15 are generally free to do whatever they wish with the bankruptcy dividends they
16 receive, including to share them with other creditors.” *Id.* (cleaned up). Such
17 agreements, however, “have been reviewed under a standard of heightened scrutiny
18 due to past abuses,” and a rebuttable presumption of impropriety applies. *Id.* at 7–8.
19 “To rebut the presumption, the case law directs the following inquiry: Has the trustee
20 fulfilled his or her basic duties? Is there a benefit to the estate; i.e., prospects for a
21 meaningful distribution to unsecured creditors? Have the terms of the carve-out
22 agreement been fully disclosed to the bankruptcy court? If the answer to these
23 questions is in the affirmative, then the presumption of impropriety can be overcome.”
24 *Id.* at 8.

25 **B. The Compromise Motion**

26 Rule 9019(a) provides in relevant part: “On the trustee’s motion and after notice
27 and a hearing, the court may approve a compromise or settlement.” Fed. R. Bankr. P.
28 9019(a). “The purpose of a compromise agreement is to allow the trustee and the

1 creditors to avoid the expenses and burdens associated with litigating sharply
2 contested and dubious claims.” *A & C Props.*, 784 F.2d at 1380–81. “The law favors
3 compromise and not litigation for its own sake, and as long as the bankruptcy court
4 amply considered the various factors that determined the reasonableness of the
5 compromise, the court’s decision must be affirmed.” *Id.* at 1381 (citations omitted).
6 “Thus, on review, [appellate courts] must determine whether the settlement entered
7 into by the trustee was reasonable, given the particular circumstances of the case.” *Id.*

8 In determining the fairness, reasonableness and adequacy of a
9 proposed settlement agreement, the court must consider: (a) The
10 probability of success in the litigation; (b) the difficulties, if any, to be
11 encountered in the matter of collection; (c) the complexity of the
12 litigation involved, and the expense, inconvenience and delay
13 necessarily attending it; [and] (d) the paramount interest of the
creditors and a proper deference to their reasonable views in the
premises.

14 *Id.* (citation omitted).

15 As stated in the Compromise Motion, FCS consented to the sale of the
16 Residence “on the condition that FCS receives 60% of the proceeds encumbered by
17 FCS’s deed of trust from the sale of the Property after payments to satisfy, in full, the
18 first priority mortgage in favor of JP Morgan Chase Bank, the next priority lien in
19 favor of Pentagon Federal Credit Union, estimated sale costs of \$90,000, insurance
20 costs and any unpaid real property taxes.” EOR 00089. FCS further “agree[d] to a
21 carve-out in the amount of 40% of the proceeds encumbered by its lien that encumbers
22 the [Residence] from the sale of the [Residence], for the benefit of the Debtor[s’]
23 bankruptcy estate,” and “to subordinate the general unsecured portion of its proof of
24 claim in the amount of \$657,245.75, to allowed general unsecured claims.” EOR
25 00089–90. The Trustee agreed to “ensure that a minimum of 50% of the net proceeds
26 received by the bankruptcy estate from the sale [would] be paid to non-administrative
27 unsecured creditors.” EOR 00090.

28 ///

1 Debtors contend that, “from a simple review of the Trustee’s analysis of the
2 factors applicable to a usual ‘9019 Motion[,]’ there is no compromise at issue.” Dkt. 8
3 at 30. According to Debtors, “without a compromise of controversy that gives rise to
4 a ‘recovery’ under the Code, there is no authority for the Trustee to sell the Debtors’
5 Residence and not pay the Debtors’ homestead exemption... through only a voluntary
6 assignment of a portion of the 3rd deed of trust.” *Id.*⁵

7 The Trustee notes “FCS filed a claim against the estate seeking payment of
8 \$900,000, \$250,000 of which was secured,” and argues that a compromise exists
9 because FCS agreed to carve out and assign a portion of its secured deed of trust to the
10 bankruptcy estate and subordinate the unsecured portion of its claim, “in exchange for
11 the Trustee’s agreement to seek a sale of the Property and to prepare all necessary
12 pleadings to obtain court approval for the same.” Dkt. 9 at 16, 26–27. In the
13 underlying Bankruptcy Action, the Trustee additionally argued the compromise
14 satisfied the heightened scrutiny required under *KVN* and was fair, reasonable, and
15 adequate under the factors set forth in *A & C Props.* EOR 00592–603, 607–09. The
16 Bankruptcy Court considered the parties arguments at the March 7 and May 2, 2023
17 hearings, before granting the Compromise Motion and approving the compromise.
18 *See* Dkt. 8 at 29–30; EOR 00615–18.

19 The Bankruptcy Court’s determination that FCS and the Trustee reached a
20 compromise of FCS’ claims and its decision to approve the compromise were logical,
21 plausible, and supported by inferences that may be drawn reasonably from the facts in
22 the record. *See KVN*, 514 B.R. at 5. The Bankruptcy Court, thus, did not abuse its
23

24
25 ⁵ Debtors’ arguments are difficult to follow and unclear as to what point exactly
26 Debtors are attempting to make. *See* Dkt. 8 at 29–36. For example, Debtors
27 acknowledge the Bankruptcy Court granted the Compromise Motion pursuant to Rule
28 9019, and that the Trustee stated he was not seeking to sell the Residence pursuant to
§ 522(g), but spend six pages arguing the compromise is not valid because there is no
“recovery” under § 522(g). Dkt. 8 at 31–36.

1 discretion in finding the compromise agreement constituted an actual compromise of
2 FCS' secured and unsecured claims and approving the compromise under Rule 9019.

3 Accordingly, the appeal is DENIED on this Issue. Having affirmed the
4 Bankruptcy Court's ruling for the reasons stated, the court need not address the
5 parties' remaining arguments on this Issue. *See* Dkt. 8 at 11, 31–36.

6 **C. The Trustee's Objection to Exemption**

7 The second Issue raised by the parties concerns whether Debtors' homestead
8 exemption attaches to the portion of FCS' recovery from the sale of the Residence that
9 FCS carved out/assigned to the bankruptcy estate under its compromise with the
10 Trustee. Debtors present a number of arguments for why they believe the Objection
11 to Exemption should have been overruled, which the court will address in turn.

12 First, Debtors argue their homestead exemption should attach to the carve-out
13 "because the *property* which gives it cash value has been exempted." Dkt. 8 at 14
14 (emphasis in original). While Debtors acknowledge "[t]here is no precedential
15 authority on whether a homestead exemption applies to a portion of a lien carved out
16 for the benefit of the estate," they argue that "the cases which say the exemption does
17 apply to the carveout are better reasoned and should be persuasive to this court." *Id.*
18 at 14, 24–27. The court disagrees.

19 "California does not permit a debtor to exempt his entire interest in a
20 homestead, but specifically limits the dollar amount up to which a homestead
21 exemption can be claimed." *In re Reed*, 940 F.2d 1317, 1321 (9th Cir. 1991) (citing
22 Cal. Code Civ. Proc. § 704.730(a)). "The statutory scheme implementing the
23 [homestead exemption] ... is said to provide protection for a portion of the *equity* in
24 the debtor's home against creditors who seek satisfaction by forced sale of the home."
25 *In re Hyman*, 123 B.R. 342, 345 (B.A.P. 9th Cir. 1991) (cleaned up, italics in
26 original). "The language of the relevant statutes makes it clear that the 'homestead
27 exemption' in California is merely a debtor's right to retain a certain sum of money
28 when the court orders sale of a homestead in order to enforce a money judgment; it is

1 not an absolute right to retain the homestead itself.” *Reed*, 940 F.2d at 1321 (citing
2 Cal. Code Civ. Proc. § 704.720(b)).

3 It is undisputed the Residence was over-encumbered, “which, based on the
4 Debtors’ valuation of the Residence, left no realizable equity in the property even
5 without taking into consideration the Debtors’ homestead exemption.” *E.g.*, Dkt. 8 at
6 5. Because FCS’ secured lien commands higher priority than Debtors’ homestead
7 exemption, FCS is entitled to recover on its secured deed of trust from a sale of the
8 Residence before Debtors are paid. *See* Cal. Code Civ. Proc. §§ 703.010(b), 704.850.
9 As stated, “[c]reditors are generally free to do whatever they wish with the bankruptcy
10 dividends they receive.” *KVN*, 514 B.R. at 6. The carve-out, thus, does not violate
11 the basic system of priority for distribution of assets of the estate, and the Bankruptcy
12 Court did not abuse its discretion in sustaining in part the Objection to Exemption and
13 finding Debtors’ homestead exemption does not attach to the carve-out funds.

14 Second, Debtors contend *Jevic*, 580 U.S. at 451, forbids a secured creditor from
15 assigning or carving out a portion of its recovery to pay unsecured creditors who are
16 lower in priority than Debtors’ homestead exemption. Dkt. 8 at 15. According to
17 Debtors, “[t]he Trustee’s carveout creates ... freed up equity, because FCS has given
18 up a portion of its secured value to the unsecured creditors,” which must be distributed
19 to Debtors because of their homestead exemption. *Id.* Debtors further argue *Jevic*
20 prohibits a high-priority creditor from “do[ing] whatever it wants with the proceeds of
21 its loan.” *Id.* The court disagrees, as Debtors seek to extend *Jevic* beyond the facts
22 and reasoning of that case.

23 In *Jevic*, 580 U.S. at 454, 460, the bankruptcy court dismissed a debtor’s
24 chapter 11 bankruptcy petition pursuant to a settlement agreement between the debtor
25 and certain creditors, without restoring the pre-petition status quo. Under the
26 structured dismissal proposed, the petitioners, who were mid-priority creditors with a
27 priority wage claim, would receive nothing while higher-priority secured creditors and
28 lower-priority general unsecured creditors would be paid. *Id.* at 460–61. The

1 Supreme Court reversed the dismissal, holding bankruptcy courts do not have “the
2 legal power to order this priority-skipping kind of distribution scheme in connection
3 with a Chapter 11 dismissal.” *Id.* at 455 (emphasis omitted).

4 The structured dismissal proposed in *Jevic* violated the basic priority system
5 because it deprived the mid-priority creditors of property interests with actual value.
6 *Id.* at 464 (“[T]he Bankruptcy Court’s approval of the structured dismissal cost [the
7 mid-priority creditors] something. They lost a chance to obtain a settlement that
8 respected their priority. Or, if not that, they lost the power to bring their own lawsuit
9 on a claim that had a settlement value of \$3.7 million.”).

10 Here, in contrast, Debtors’ property interests and position remain unaffected by
11 the bankruptcy court’s approval of the compromise because Debtors have no
12 realizable equity in the Residence to protect. FCS’ decision to carve out a portion of
13 its recovery on the third deed of trust for the bankruptcy estate does not reduce in any
14 way Debtors’ expected recovery under the homestead exemption. The distribution
15 approved by the Bankruptcy Court does not deviate from or violate the basic priority
16 rules for distribution. If anything, *Jevic* would support affirming the Bankruptcy
17 Court’s ruling, since requiring FCS to give up a portion of its recovery on its secured
18 lien to Debtors, without FCS’ consent, would violate the ordinary rules of priority.

19 *Jevic* neither considered nor discussed whether a high-priority secured creditor
20 can assign or carve out a portion of its own recovery for the benefit of the bankruptcy
21 estate and low-priority general unsecured creditors, and does not support Debtors’
22 contention that a high-priority secured creditor may not agree to carve out a portion of
23 its recovery for the bankruptcy estate. Debtors’ argument, thus, fails.

24 Third, Debtors contend the language and policies stated in *Tillman* establish
25 that the Residence has been withdrawn from the estate because of their homestead
26 exemption. Dkt. 8 at 19–20. Debtors note the Ninth Circuit recognized ““an
27 exemption is an interest *withdrawn* from the estate (and hence from the creditors) for
28 the benefit of the debtor,”” *id.* at 19 (citing *Tillman*, 53 F.4th at 1168 (emphasis in

1 original))), and argue their homestead exemption withdraws the Residence from the
2 estate, “subject to the three trust deeds and the [United States Internal Revenue
3 Service (“IRS”)] tax liens, which the Debtors must deal with outside of the bankruptcy
4 proceedings.” *Id.* at 20.

5 In *Tillman*, 53 F.4th at 1163, the Ninth Circuit held that a trustee may not avoid
6 a tax lien on property subject to Arizona’s homestead exemption and preserve the
7 value of the lien for the benefit of the bankruptcy estate under §§ 551 and 724(a).
8 Neither §§ 551 nor 724(a) are at issue in the subject appeal, and *Tillman* is
9 inapposite.⁶

10 Even if the court were to assume *arguendo* that *Tillman* established a policy
11 whereby Debtors’ homestead exemption withdraws their property interest from the
12 estate, such a policy would be irrelevant here since Debtors admit the Residence is
13 over-encumbered and there is no realizable equity to which the homestead exemption
14 could attach. *See* Dkt. 8 at 5, 10–11. Because Debtors have no realizable property
15 interest in the Residence, there is nothing to withdraw from the estate based on the
16 homestead exemption. Debtors’ argument, thus, fails.

17
18 ⁶ In *Tillman*, 53 F.4th at 1164–65, the trustee filed an adversary proceeding, seeking
19 leave to avoid the federal tax lien on the debtor’s property, pursuant to § 724(a), and
20 preserve the value of the avoided federal tax lien for the benefit of the bankruptcy
21 estate, pursuant to § 551. Unlike California law, Arizona’s homestead exemption
22 “does *not* provide for any reduction in the exemption amount for tax liens.” *Tillman*,
23 53 F.4th at 1163 (emphasis in original). Nevertheless, the bankruptcy court held that
24 the debtor was entitled to exempt only equity beyond the mortgage and tax lien
25 because Arizona’s exemption laws were “ineffective” against the federal tax lien, and
26 granted summary judgment in the trustee’s favor. *Id.* at 1165. After examining the
27 statutory text of § 724(a) in context with other provisions of the Bankruptcy Code, the
28 Ninth Circuit held that “§ 724(a) concerns the trustee’s avoidance of qualifying liens
attached to the *property of the estate* at the time of *distribution*.” *Id.* at 1169
(emphasis in original). The Ninth Circuit “conclude[d] that § 724(a) does not permit a
trustee to avoid a tax lien secured by exempt property because such securing property
is not property of the estate,” and reversed the bankruptcy court’s ruling. *Id.* at 1171.
Tillman is inapposite to the appeal at hand.

1 Fourth, Debtors argue the court may use similar reasoning as stated in *In re*
2 *Christensen*, 561 B.R. 195 (Bankr. D. Utah 2016), *aff'd In re Bird*, 577 B.R. 365
3 (B.A.P. 10th Cir. 2017), “to deny the Compromise and the distribution scheme it
4 contemplates from a proposed sale which ignores the homestead exemption on
5 property withdrawn from the estate.” Dkt. 8 at 23. *Christensen* is a non-binding
6 bankruptcy court opinion from outside this Circuit, which involves Utah state law, and
7 which is distinguishable from the facts at hand.

8 In *Christensen*, 561 B.R. 197–98, the trustee and the IRS entered into an
9 agreement whereby “the trustee agreed to market and sell the debtors’ homes despite
10 the fact that they were over-encumbered” and “the IRS agreed to subordinate its lien
11 insofar as necessary to provide \$10,000 to each estate, while the trustee and his
12 counsel would use 11 U.S.C. § 724(b) to have their fees and costs paid in full from the
13 sale proceeds prior to the IRS.” *Christensen*, 561 B.R. 197–98. The bankruptcy court
14 denied the trustee’s application for compensation and reimbursement of expenses,
15 finding the trustee’s services were neither necessary to the administration of the case
16 nor likely to benefit the estate. *Id.* at 217–18. In particular, the bankruptcy court
17 noted that it was problematic for the trustee to negotiate a sale that would benefit the
18 secured creditor and trustee primarily, while prejudicing junior lien holders and the
19 debtor. *Id.* at 210–17; *see also id.* at 211 (“Some courts have held that a secured
20 creditor and the trustee may agree that the trustee may receive a ‘tip’ or ‘incentive
21 bonus’ for doing a secured creditor’s dirty work. The Court finds these cases
22 unpersuasive. ... A debtor is not permitted to negotiate a short sale with a secured
23 creditor and retain proceeds when the property is subject to a junior lien, and neither is
24 the trustee. Even if the ‘tip’ or ‘incentive bonus’ results from the trustee’s exercise of
25 his authority as trustee, it is unavoidably proceeds of property of the estate.”).

26 Unlike in *Christensen*, 561 B.R. at 212, the compromise here does not inure
27 primarily to FCS and the Trustee’s benefit, with “[a]ny benefit to unsecured creditors
28 [being] purely incidental.” FCS did not agree to subordinate a portion of its secured

1 lien—it agreed to assign a portion of its recovery from its secured claim to the
2 bankruptcy estate while subordinating its unsecured claims to ensure that other
3 unsecured creditors received the transferred funds. EOR 00090. The Trustee, in turn,
4 agreed to “ensure that a minimum of 50% of the net proceeds received by the
5 bankruptcy estate from the sale [would] be paid to non-administrative unsecured
6 creditors.” *Id.*

7 In the underlying proceedings, the Trustee argued that this agreement would
8 provide a meaningful benefit to the unsecured creditors and satisfied the requirements
9 of *KVN*. *E.g.*, EOR 00510–11, 578–80. Debtors did not dispute the value of the
10 distribution and argued only that the carve out would not benefit the estate because
11 Debtors were entitled to the funds because of their homestead exemption. *E.g.*, EOR
12 00568. At the hearings on the Compromise Motion, the Bankruptcy Court found the
13 Trustee “clearly satisfied” the *KVN* factors, noting the compromise provided “a
14 spectacularly good result for creditors” and “frankly, a better result for creditors than
15 is achieved in most Chapter 7 bankruptcy cases.” EOR 00594, 617–18. *Christensen*
16 is distinguishable, and the court will not grant the appeal on this basis.

17 Finally, Debtors contend “Bankruptcy Code section 105, longstanding
18 policies[,] and equity weigh against a trustee selling fully encumbered property and
19 evicting debtors.” Dkt. 8 at 37 (cleaned up). According to Debtors, the court should
20 exercise its powers under §§ 105(a) or 522 “to deny the Trustee’s ‘Compromise’ and
21 abolish the order of distribution orchestrated by the Trustee and FCS ... because this
22 outcome is an abomination, to be struck down, not admired.” Dkt. 8 at 37.⁷ The court
23 _____

24 ⁷ Debtors state they “were aware when they filed their chapter 7 petition that their
25 home was underwater when the tax liens were taken into account” and were advised
26 “they could expect to discharge their dischargeable debts and receive a fresh start
27 from the bankruptcy, which would then allow them to address the secured debts while
28 maintaining their residence.” Dkt. 8 at 37. The Trustee states, and Debtors do not
dispute, that Debtors have not made mortgage payments since the Petition Date and

1 disagrees for the reasons stated, and declines to reverse the Bankruptcy Court's
2 rulings on this basis.⁸

3 In sum, the court finds the Bankruptcy Court did not abuse its discretion in
4 sustaining in part the Trustee's Objection to Exemption, and DENIES the appeal on
5 this Issue.

6 **D. The Abandonment Motion**

7 "On request of a party in interest and after notice and a hearing, the court may
8 order the trustee to abandon any property of the estate that is burdensome to the estate
9 or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(b).

10 "[T]he principle of abandonment was developed to protect the bankruptcy estate from
11 the various costs and burdens of having to administer property which could not
12 conceivably benefit unsecured creditors of the estate." *KVN*, 514 B.R. at 6 (cleaned
13 up). "[A]n order compelling abandonment is the exception, not the rule.

14 Abandonment should only be compelled in order to help the creditors by assuring
15 some benefit in the administration of each asset. Absent an attempt by the trustee to
16 churn property worthless to the estate just to increase fees, abandonment should rarely
17 be ordered." *In re Vu*, 245 B.R. 644, 457 (B.A.P. 9th Cir. 2000) (cleaned up). A
18 party seeking abandonment of estate property bears the burden of showing by a
19 preponderance of the evidence that the property is burdensome or of inconsequential
20

21 are in default under their consensual mortgages. Dkt. 27 at 37. Debtors chose
22 voluntarily to file a petition for chapter 7 bankruptcy and render the Residence an
23 asset of the bankruptcy estate, subject to the provisions of the Bankruptcy Code.
24 Their expectation that the Residence would be abandoned and disappointment with
25 the Bankruptcy Court's rulings, while understandable, do not establish a legally
26 protectable interest.

27 ⁸ The Trustee cites *Law v. Siegel*, 571 U.S. 415, 421 (2014), to argue § 105(a) cannot
28 be used to contravene specific statutory provisions of the Bankruptcy Code. Dkt. 9 at
40. As the court finds reversal is not warranted here, the court declines to consider
whether a court could exercise its powers under § 105(a) to reverse a bankruptcy
court's approval of a carve-out under different circumstances.

1 value and benefit to the estate. *See id.* at 650.

2 Debtors contend the Bankruptcy Court erred in denying the Abandonment
3 Motion because the Residence was over-encumbered and of inconsequential value and
4 benefit to the estate due to Debtors' homestead exemption. Dkt. 8 at 11–12, 28. The
5 Trustee responds the Bankruptcy Court did not abuse its discretion in denying the
6 Abandonment Motion because the Residence has substantial value and benefit for the
7 estate, which is expected to receive \$100,000 from the carve-out, with at least 50% of
8 the net proceeds to be paid to non-administrative unsecured creditors. Dkt. 9 at 41.

9 For the reasons stated, the Bankruptcy Court did not abuse its discretion in
10 finding that the compromise was of substantial benefit to the estate and denying the
11 Abandonment Motion. The appeal is DENIED on this Issue.

12 **IV. Conclusion Regarding May 2, 2023 Order**

13 In sum, the court AFFIRMS the Bankruptcy Court's rulings and the May 2,
14 2023 Order in its entirety.

15 **SEPTEMBER 8, 2023 ORDER**

16 Debtors' appeal of the September 8, 2023 Order centers on the following Issue:
17 Whether the Trustee can sell the Residence and pay general unsecured creditors and
18 administrative expenses from the proceeds of the sale, pursuant to the stipulation
19 approved by the Bankruptcy Court, before Debtors are paid their homestead
20 exemption. *See* Dkt. 26 at 11; Dkt. 27 at 2. As Debtors repeat many of the arguments
21 they raised in connection with their appeal of the May 2, 2023 Order (*see* Dkt. 26 at
22 11–24, 28–31), the court will address only the new arguments raised in connection
23 with this appeal.

24 First, Debtors contend the Trustee makes the same argument in his Sale Motion
25 as was raised in *in re Traverse*, 753 F.3d 19 (1st Cir. 2014). Dkt. 26 at 25. While
26 Debtors admit *Traverse* involved “a slightly different scenario,” they argue the First
27 Circuit's reasoning precludes the Trustee from being able to sell the Residence here.
28 *Id.* at 25–28. *Traverse* is a non-binding decision from outside this Circuit that is

1 distinguishable from the facts here.

2 In *Traverse*, 753 F.3d at 23, the trustee sought to avoid and preserve an
3 unrecorded mortgage and to sell the debtor's residence as property of the bankruptcy
4 estate. The First Circuit held that the trustee could not sell the residence because "the
5 preservation of a lien entitles a bankruptcy estate to the full value of the preserved
6 lien--no more and no less." *Id.* at 31. As the First Circuit explained:

7 Where this lien is an undefaulted mortgage on otherwise exempted
8 property, the trustee may for the benefit of the estate enjoy the liquid
9 market value of that mortgage, claim the first proceeds from a
10 voluntary sale, or wait to exercise the rights of a mortgagee in the
11 event of a default. But the trustee may not repurpose the mortgage to
12 transform otherwise exempted assets, to which neither the estate nor
the original mortgagee boasted any ownership rights, into the property
of the bankruptcy estate.

13 *Id.*

14 *Traverse* does not establish that a trustee cannot sell real property that a debtor
15 has made property of the estate through a chapter 7 petition, as occurred here.
16 Furthermore, the Trustee contends, and Debtors do not dispute, that Debtors have not
17 made payments on the deeds of trust since the Petition Date and are in default under
18 their consensual mortgages. Dkt. 27 at 37. Unlike in *Traverse*, FCS and the trustee
19 have an ownership interest that entitles the Trustee to sell the Residence. *Traverse* is
20 inapposite, and Debtors' argument fails.

21 Second, Debtors argue that even if FCS' compromise with the Trustee
22 constituted a valid settlement, it did not grant the Trustee the power to sell the
23 Residence without paying Debtors their homestead exemption because "nothing here
24 allows the Trustee to jump from receiving an assignment of a deed of trust and do
25 anything else other than exercise the same rights FCS had under its deed of trust,
26 which here, is to foreclose." Dkt. 26 at 24. According to Debtors, "[b]ecause the
27 Trustee, here, did not 'recover' property pursuant to section 510(c)(2), which is the
28 only bridge that gets the Trustee from receiving an 'assignment' or 'carveout' from a

1 secured lender, and then to authority to 1) sell the property; and 2) not pay the
2 Debtors' homestead exemption, which is section 522(g)." *Id.* (errors in original).

3 Debtors' argument is again largely incomprehensible.⁹ For one, it is unclear
4 why Debtors are challenging the Trustee's authority to sell the Residence under
5 § 522(g), given: (1) the Trustee brought the Sale Motion pursuant to § 105(a),
6 § 363(b), (f), and (m), and Federal Rule of Bankruptcy Procedure 6004(a)—not
7 § 522(g) (EOR 00640); and (2) the Bankruptcy Court did not identify § 522(g) as a
8 basis for its ruling (*see* EOR 000780–81, 798–807), or discuss that statute other than
9 to explain why "[t]he 522(g) issue isn't relevant here" (EOR 00597).

10 Debtors do not explain clearly why the Trustee would need to "recover"
11 property under § 510(c)(2) to have the authority to sell the Residence or why the
12 transfer of funds pursuant to the carve-out agreement does not qualify as a recovery
13 even if the court were to assume *arguendo* that § 510(c)(2) applies.¹⁰ In contrast, the
14 Trustee argues he is authorized to sell the Residence because he satisfied the standards
15 for a sale under § 363(b). Dkt. 27 at 19–25.

16 The Bankruptcy Court found the Trustee satisfied the business judgment
17 standard for selling the Property under § 363. EOR 00798–804. Debtors do not
18

19
20 ⁹ Debtors raised the same argument in their reply in support of their appeal of the May
2, 2023 Order. Dkt. 11 at 6–11. The argument was no clearer there.

21 ¹⁰ Debtors contend *KVN* is distinguishable because that decision "relied on section
22 522(g) to proceed with a sale that subordinated the debtors' homestead exemption."
23 Dkt. 26 at 24. According to Debtors, "[b]ecause [the] trustee in *KVN* ... recovered
24 property in litigation, and obtained a subordination from the lender under section §
510(c)(2), [the trustee] proceeded under 522(g) to sell and not pay the debtors'
25 homestead exemption on the subordinated portion of the lender's claim in the hands of
the [t]rustee." *Id.* *KVN* did not rely on §§ 510(c)(2) or 522 for any portion of its
26 reasoning, and cited § 522 only to distinguish a case in which the trustee sought to
27 disallow an exemption under § 522(c)(1). *KVN*, 514 B.R. at 9. Debtors do not cite
28 any legal authority in support of their arguments, and it is unclear why they believe
KVN "relied on section 522(g)." Debtors' argument, thus, fails.

1 present any argument regarding the relevant factors and argue only that the Trustee
2 cannot sell the Residence because exempt property is withdrawn from the estate under
3 *Tillman*. Dkt. 26 at 28. This argument fails for the reasons stated.

4 In sum, Debtors fail to demonstrate the Trustee lacked the authority to sell the
5 Residence or that there is any other valid basis to prevent the sale. The court,
6 therefore, AFFIRMS the Bankruptcy Court's rulings and the September 8, 2023 Order
7 in its entirety.

8 **CONCLUSION**

9 For the aforementioned reasons, the court AFFIRMS the Bankruptcy Court's
10 May 2 and September 8, 2023 Orders and DISMISSES the subject appeals.

11
12 IT IS SO ORDERED.

13
14 Dated: March 27, 2025



15 FERNANDO L. AENLLE-ROCHA
16 United States District Judge
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